

Memorandum

: Honorable Brad Sherman
Honorable Ernest J. Dronenburg, Jr.
Honorable Matthew K. Fong
Board Member, First District
Honorable Gray Davis

Date: December 28, 1993

From : E. L. Sorensen, Jr.
Chief Counsel

Subject: Pro-Ration Opinion for . and

Attached is the opinion you requested in the above cases on inter- and intrastate pro-ration of flat monthly charges for purposes of application of the Moore Act Tax and the Emergency Telephone User's Surcharge. Because you requested this opinion from the Legal Department, I have designated it as subject to the attorney-client privilege. That privilege, of course, can be waived by the Board acting as a whole.

cc: Burton W. Oliver
Don Hennessy
Larry Augusta
A. K. Stuckey
Monte Williams
Susan Scott

E. L. Sorensen, Jr.

Memorandum

Attorney-Client Privilege

To : Honorable Brad Sherman
Honorable Ernest J. Dronenburg, Jr.
Honorable Matthew K. Fong
Board Member, First District
Honorable Gray Davis

Date: December 23, 1993

From : E. L. Sorensen, Jr.
Chief Counsel

Subject: Pro-Ration of 9-1-1 and Moore Act Taxes on Monthly Service Flat
Rate Charges in :

Pursuant to the request of the Board, this opinion is limited to consideration of the issue raised in both of the above cases as to the propriety and feasibility of apportioning between interstate and intrastate telecommunications certain flat rate monthly fees charged by service suppliers and applying the Universal Lifeline (Moore Act) Tax and Emergency Telephone Users Surcharge (9-1-1 Surcharge) only to the intrastate portion. Both statutes clearly provide for taxation of "monthly service flat rate charges"¹, but neither statute defines the scope of that term. Since the inception of both programs, the Department has been fully taxing any flat rate monthly charges if the service supplier conditions intrastate service upon its payment.

¹The Moore Act provided for taxation of "all revenues billed by a service supplier for the provision of intrastate telecommunications services, including revenues derived from monthly service flat rate charges, message unit charges, and intrastate wide area telephone service charges, and any other flat rate or usage charge..." (Rev. & Tax. Code §44024.)

The 9-1-1 Surcharge imposes the tax on "all charges billed by a service supplier to a service user for intrastate telephone communications services and shall mean local telephone service and include monthly service flat rate charges for usage, message unit charges and shall mean toll charges, and include intrastate-wide area telephone service charges." (Rev. & Tax. §41011.) The Surcharge Law also provides that the surcharges "shall be collected insofar as practicable at the same time as, and along with, the charges made in accordance with regular billing practice of the service supplier." (Rev. & Tax. Code §41045.)

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Both Petitioners are "service suppliers" under the two statutes, supplying interLATA intrastate services under state tariffs and interstate service under federal regulation. The charges at issue in are "local exchange access fees", billed subscribers to reimburse the company for its local access costs, and "subscription fees" for the recovery of other fixed administrative costs. In , the charges are minimum usage fees², connection charges, charges for services outside the rate center and special access charges. Both Petitioners have made various arguments for total exemption of their flat rate charges from imposition of any Moore or 9-1-1 taxes³, but this opinion discusses only their alternative "apportionment" or "pro-ration" argument.

²Minimum usage fees convert to usage-sensitive charges if calls are made during the billing period. The Department considers the minimum usage fee to be a "monthly service flat rate charge" only if the end user makes no calls and the full fee is charged. Accordingly, it is only the taxation of fees imposed during periods of non-usage that is at issue in case.

³As explained by counsel for the Department at the hearing on March 19, 1993, the cases cited by petitioner in its hearing brief for the proposition that access charges are not properly characterized as taxable intrastate revenue relate to pre-divestiture billing and taxing schemes in other jurisdictions and are simply not applicable to the instant case. Southern Pacific Communications Co., 1990 N.Y. Tax Lexis 111 (1990); State of Illinois v. MCI Telecommunications Corporation, Illinois Department of Revenue No. M-677; City of Glendale v. MCIT, Superior Court of Arizona, Maricopa County, No. TX 88-00757, (March 30, 1990); In the Matter of GTE Sprint Communications, Arizona Department of Revenue, Case No. 96357-S. Moreover, the Illinois cases dealt with a statute which taxed intrastate "telecommunications", not "revenues received from intrastate telecommunications service" (Moore Act) or "charges for services" (9-1-1 Surcharge). The Arizona MCI case -- the only case involving minimum use charges, dealt with city "transaction privilege" minimum use taxes on actual call charges -- as opposed to access charges -- by a long-distance carrier authorized only to carry interstate calls and whose occasional traffic in intrastate calls was only an "incidental service" to subscribers. Since divestment, long distance carriers have entered the intrastate interLATA market as a primary component of the subscription service.

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Although the pro-ration argument has been raised in several other cases, the Board has consistently rejected it⁴ and it has yet to receive consideration by the courts⁵. The only case cited by Petitioners in which any fees were apportioned on the basis of inter- and intrastate calling is City of Glendale v. MCIT, an Arizona Superior Court decision involving taxation of minimum use charges for long-distance telephone services under a city "transaction privilege" (sales) tax statute with no specific provision for taxation of flat monthly service charges. The Superior Court upheld the hearing officer's apportionment remedy in the face of the city's contention that the entire fee was subject to the tax, agreeing with the taxpayer's characterization of the fees as advances on the calls themselves. The analysis is minimal and mainly related to the hearing officer's remedial powers, and it is not clear whether the audit period is before or after divestment; but it is worth noting that the approved result is precisely the approach taken by our Department with respect to minimum usage fees.

Although many states impose taxes on "intrastate" telecommunications, we are aware of none which apportion flat rate service charges on the basis of customer interstate and intrastate usage.

The Department argues that apportionment is not authorized by the statute, is not feasible to administer, and would have serious revenue repercussions because it would have to be applied to all monthly service flat rate charges if it were applied to any. The Petitioners argue that specific authorization to apportion is not necessary and rely primarily on the statutory language confining the tax to revenues for intrastate services. Petitioners do not address the difficulty posed by administration of apportionment or its revenue implications. As both of the

⁴See
overturned on other grounds by the First District Court of Appeal in GTE Sprint Communications Corp. v. State Board of Equalization (1991) 1 Cal.App.4th 827;

1993.

⁵In GTE Sprint Communications Corp. v. State Board of Equalization (1991) 1 Cal.App.4th 827, the Court of Appeal found that, until 1984, when GTE Sprint became subject to state P.U.C. tariff for supplying intrastate service, it was not a "service supplier" under amended section 41006 and for that reason, was entitled to a full -- not pro-rated -- refund of 9-1-1 surcharges.

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Petitioners in this case are long-distance carriers, neither has proposed to extend the apportionment concept to monthly FCC-mandated charges or any other monthly flat rate charges made by the local exchange companies.

Historical Context of 9-1-1 Surcharge and Moore Act

The historical context of the statutes and subsequent development of telecommunications billing practices provides a strong indication that the legislature intended to tax 100% of any monthly service flat rate charges imposed as a condition of intrastate service.

Both of the statutes at issue were enacted before the AT&T divestiture, but the Moore Act was drafted in anticipation of the changes that divestiture would bring and antitrust issues and industry structural concerns pre-date both statutes. Both the Lifeline and Emergency funds required the stable measure of revenues provided by 100% taxation of the then-current monthly service flat rate charges, which at that time were those charges imposed by the local exchange companies and which necessarily covered local plant costs associated both with intra- and interstate service. (See Louisiana Public Service Commission v. F.C.C. (1986) 476 U.S. 355, 360 [90 L.Ed.2d 369].) There is no reason to infer that the legislature believed that billing and cost recapture approaches current at the time the statutes were enacted would be continued into the future.

After the AT&T divestiture, new billing mechanisms had to be devised to enable local exchange companies to recover their costs. FCC-imposed charges, denominated "interstate access" charges but actually imposed regardless of interstate access or usage⁶, provided a federally-regulated subsidy to local companies, and the local companies themselves charged long-distance carriers for access to the local networks. In addition, numerous new services were developed for application to both intra and interstate calling, such as call waiting and forwarding and dedicated line services.

Whether a call placed by a subscriber of was made to a point inside or outside the state, access to the local network was required, and for a time, many long-distance carriers chose to recover their local access costs and other costs of doing business by flat monthly charges to their subscribers such as the ones at issue in these cases. These

⁶ See Department's brief in case, filed October 15, 1993.

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charges neither accounted for nor related to the usage pattern of the individual subscriber or of the subscriber base so that even subscribers who never made an interstate call during the billing period were required to share the cost of their long-distance carriers' local access. Similarly, the local access payments of long-distance subscribers who never made an intrastate call were subjected to 9-1-1 and Moore Act taxes as charges billed for "intrastate services."

As most costs to the telecommunications industry are non-usage sensitive, flat rate charges began to proliferate after 1984 as a reasonable and fair means of spreading the costs of doing business. (See National Association of Regulatory Utility Commissioners v. Federal Communications Commission, 737 F.2d 1095 (D.C. Cir. 1984), cert. denied, 469 U.S. 1227, 105 S. Ct. 1224, 84 L.Ed.2d 364 (1985).) Essentially, then, the original flat rate monthly charges billed by the local exchange companies metamorphosed into numerous flat rate monthly charges whereby both local and long-distance carriers cover their costs by conditioning intrastate subscriber access.

The legislature has made no changes to the "monthly service flat rate charges" language to reflect the changes in billing or to confine the reference to any specific charges billed by a local exchange company. Neither has it provided a mechanism for apportionment.⁷

Administrative Feasibility of Apportionment

The greatest obstacle to apportioning flat rate charges is in identifying and developing a factor or factors for apportionment. Billing methods used by service suppliers have not always allowed for identification of the origination and termination point of telecommunications. The service suppliers which have argued in favor of pro-ration have proposed numerous different methods, all of which are flawed in some vital respect.

suggests using their company-specific Percentage Interstate Usage (PIU) factor developed periodically for local exchange companies' billing purposes. seems to assume an

⁷More recently, long-distance carriers have chosen to recover their costs of doing business on a usage-sensitive basis, by adding them to the actual call charges, rather than billing them separately as flat charges. Consequently, the heavier users -- be they inter or intra-state or both -- now bear the brunt of the carriers' access and other costs, but only the intrastate callers pay the Moore and 9-1-1 taxes.

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individualized accounting would be made for each customer. argued that the same interstate usage factor should be used for both of its Telex programs, although one of the programs was billed on the basis of electronic signals so that distinguishing between interstate and intrastate telegraphs was impossible. The difficulties of identifying origination and termination points in cellular transmissions are such that some cellular carriers presently pay the surcharge on usage charges for all calls. The proliferating choices in telecommunications services as well as the fact that some local exchange companies' bill for long-distance carriers and others do not stand to further exacerbate the feasibility problems of pro-ration. For example, a small local exchange company that does not bill for a long distance carrier would be unable to use an individual pro-ration factor for its flat fees. The Department correctly forecasts the necessity for massive overhaul of suppliers' billing practices, a result which clearly contradicts the legislative intent behind the 9-1-1 Surcharge provision that the surcharge be billed "in accordance with [the service suppliers'] regular billing practice." (Rev. & Tax. Code §41045.)

Revenue Implications of Pro-ration

As noted above, costs originally covered by local exchange companies' monthly service flat rate charges were spread after divestiture over a multitude of flat rate charges, including the FCC-mandated charge to reimburse local exchanges for long distance companies' use of their facilities and networks, special service charges for call-waiting and call-forwarding, access and minimum usage charges for local exchanges and WATS lines, WATS charges for "services outside the rate center", "subscription" charges, and access and "roamer" charges for cellular. Some of these charges are billed by the local companies and some by the long distance carriers. Because of the nature of the technology and dual usage of the local plant and facilities, all of the charges billed by the long-distance, the local exchange and the cellular companies relate at least potentially to both inter and intrastate service and access. All three are "service suppliers" under the statutes, and there is therefore no logic that would justify pro-rating and imposing the tax on one monthly service flat rate charge but not on another.

As the attached analyses prepared by the Excise Taxes Division of Special Taxes and Administration indicates, pro-ration of all monthly service flat rate charges based on a P.U.C.-estimated percentage of intra- versus interstate calls would result in a \$2,186,951,304 loss in the measure of revenue for the 9-1-1 program and a \$15,089,964 loss in actual revenue. Because the 9-1-1 program anticipates virtually full use of its

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revenues⁸ --especially given the additional poison control services added by S.B. 1016-- full funding would require a 20% increase in the surcharge rate (to .89%) to offset the shortfall occasioned by pro-ration. Because the current statute provides for a maximum tax rate of .75%, such an increase would necessitate legislative action.

Conclusion

Pro-ration of all monthly service flat rate charges for purposes of Moore Act taxes and 9-1-1 Surcharges is neither required by the language of the statutes nor workable administratively, and there is no logical basis for breaking down the flat rate charges into those which should be pro-rated and those which should not. Pro-ration would also necessitate legislative action to increase the maximum surcharge rate and supplement revenues to avoid underfunding of the 9-1-1 program.



SS:ph
Attachments

cc: Burton W. Oliver
Don Hennessy
Larry Augusta
A. K. Stuckey
Monte Williams
Susan Scott

If you have any questions regarding this opinion, please feel free to contact Susan Scott, Staff Counsel at (916) 327-2455.

⁸According to Leah Senitte, the 9-1-1 Program Manager at Department of General Services, the program anticipates revenues for FY 1993-1994 of approximately \$67 million and has an approved spending authorization from Department of Finance of \$65 million.

EXHIBIT #1 - FUTURE REVENUE LOSS DUE TO PRORATION

page 1

Local Exchange Carriers-FCC Access Charge Revenue

1993 population per Calif. Almanac		34,750,169
Divided by average Calif. Household per Almanac		2.68
Estimated # residential lines in Calif. (**)	(L2*L3)	12,966,481
FCC access charge per residential line		\$3.50
Estimated monthly residential FCC access charge revenue	(L4*L5)	\$45,382,684
Estimated # residential lines in Calif.	(L4)	12,966,481
Multiplied by ratio of business to residential lines per Pacific Bell		54%
Estimated business lines in Calif. (**)	(L8*L10)	7,001,900
FCC access charge per business line		\$8.10
Monthly business FCC access charge revenue	(L11*L12)	\$56,715,390
Estimated monthly FCC access charge revenue	(L6+L13)	\$102,098,074

Local Exchange Carriers-Monthly Service Access Charge Revenue

Estimated # residential lines in Calif.	(L4)	12,966,481
Average residential monthly service charge		\$8.75
Estimated residential monthly service charge revenue	(L19*L20)	\$113,456,709
Estimated # business lines in Calif.	(L4*54%)	\$7,001,900
Average business monthly service charge		\$16.00
Estimated business monthly service charge revenue	(L23*L24)	\$112,030,396

Local Exchange Carriers-Monthly Associated Services Charge Revenue @@

Estimated # residential lines in Calif.	(L4)	12,966,481
Average cost of associated services		\$3.00
% of Residential lines with associated services		75%
Estimated monthly associated service charge revenue	(L29*L30*L31)	\$29,174,582
Total LEC monthly service charges subject to proration	(L15+L21+L25+L32)	\$356,759,761
Estimated interstate % (##)		45%
Estimated interstate portion of LEC monthly service charges		\$160,541,892
9-1-1 surcharge rate		0.69%
Estimated monthly 9-1-1 revenue loss		\$1,107,739
Estimated annual 9-1-1 revenue loss		\$13,292,868

** (confirmed by C

(confirmed by Facil of PUC)

@@ i.e. call waiting, call forwarding

1	<u>Cellular Carriers-Monthly access charge revenues</u>		
2	Total subscriber lines per PUC study-1991 (##)		1,069,850
3	Anticipated growth rate per PUC study (##)		0.39
4	Total subscriber lines-1993	(L2*1.39*1.39)	2,067,057
5	x average monthly access charge per PUC study (##)		\$40
6	Estimated Cellular monthly access charge revenues	(L4*L5)	\$82,682,280
7			
8	<u>Cellular Carriers-Monthly roamer charge revenues</u>		
9	Total subscriber lines-1993	(L2)	2,067,057
10	Daily roamer charge		\$2
11	Estimated Cellular monthly roamer charge revenue	(L9*L10)	\$4,134,114
12			
13	Total cellular monthly charges subject to proration	(L6+L11)	\$86,816,394
14	x estimated interstate % ##		25%
15	Interstate portion of cellular monthly charges	(L13*L14)	\$21,704,099
16	9-1-1 surcharge rate		0.69%
17	Estimated monthly 9-1-1 revenue loss	(L15*L16)	\$149,758
18	Estimated annual 9-1-1 revenue loss	(L17*12)	\$1,797,096
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20	<u>Summary</u>		
21	LEC-Estimated annual 9-1-1 revenue loss	(L40 page 1)	\$13,292,868
22	Cellular-Estimated annual 9-1-1 revenue loss	(L18 page 2)	\$1,797,096
23	Total estimated annual 9-1-1 revenue loss	(L21+L22)	\$15,089,964
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50	## (confirmed by Facil of PUC)		

EXHIBIT #2 - PROJECTED 9-1-1 RATE TO OFFSET FUTURE REVENUE LOSS

1	Total annual estimated revenue loss if proration accepted	(Ex.1 pg.2 L23)	\$15,089,964
2	Measure of estimated revenue loss	(L1/.69%)	\$2,186,951,304
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5	FYE 92/93 Actual 9-1-1 revenue		\$66,943,851
6	Measure of actual revenue	(L5/.69%)	\$9,702,007,391
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9	Anticipated FYE 92/93 measure if proration ordered		
10	(line 6 - line 2)	(L6-L2)	\$7,515,056,087
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13	Estimated additional Surcharge Needed	(L1/L10)	0.20%
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15	Minimum 9-1-1 surcharge rate to fund program	(L13 + .69%)	0.89%
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